



# Role

# MODELS



By stripping out emotion the investment team at ENISO Partners was able to withstand the worst start to a year in recorded stock market history. The systematic pioneers talk to **Margaryta Kirakosian** about getting past black box conversations to the heart of the matter and what really drives performance

ust like his role model, Warren Buffett, Adrian Wenzel is highly disciplined and pursues his long-term investment vision with tenacity.

Over the course of his career he slowly put together and then refined the principal idea behind ENISO Partners: a systematic approach to investment based on asset allocation and stock selection.

Initially, Wenzel adopted a traditional approach, selecting Swiss equities based on management interviews, research and conversations with brokers.

'This traditional approach didn't work out for me. I was never happy with it as I could never say for sure why the stock performed well or why the situation in the company was not as good as the management told me.'

It was while he was an equity manager at Baloise Asset Management that Wenzel started to develop an objective, systematic way to assess stocks.

'I was thinking at the time that perhaps I should leave the industry, as it seemed random to me. The time at Baloise was a game changer, as it gave me the freedom to start constructing the value-driven models I use today.'

He continued refining this combination of asset allocation and systematic stock selection during his time as head of asset management equities for Switzerland at Bank Sarasin.

'A new management team was coming to Sarasin and they wanted to follow a more marketing-driven approach. Then we decided to start our own business, ENISO Partners, and follow systematic selection with no emotions attached.'

There are very few purely systematic players in Switzerland, and Wenzel considers his firm to be the a pioneer in the field. Ninety per cent of Swiss asset management companies apply the systematic approach inconsistently and only at the pre-screening stage, he says.

'We decided to go down the pure systematic path from A to Z. It helps us to distinguish ourselves in the Swiss asset management scene.'

In the highly technical world of systematic asset management Wenzel is up against asset managers with mathematics backgrounds, and he acknowledges it's hard to compete in the realm of algorithms.

However, the maths whiz-kids don't have the same level of financial market common sense, which comes only with experience, he says.

'They all know the same algorithms and they are trying to tweak them, to make them faster. But they all go in the same direction. It reminds me of a crowded trade but on a model level. It is like Darwinism. You have to adapt quickly to the changing world or create models that fix themselves, and this is what we are trying to do.'

#### FULL EQUITY EXPOSURE

Wenzel's passion is basketball. Team spirit lies at the heart of the game, and the same applies for the structure of ENISO Partners.

'It is always great to win as part of the team, using skills of different players or co-workers. We only have seven people at the firm, so it is very important to work together.'

Wenzel works particularly closely with portfolio manager Oliver Collins (pictured right), who plays a central role in asset allocation decisions. Collins has been with ENISO since 2014, and is primarily concerned with the fixed interest side of the business.





Wenzel and Collins typically invest up to 70% of their assets in equities, with the remainder held in cash or bonds. However, they do have the flexibility to go all-in with equities if the market backdrop and risk appetite of the client are right.

'At the moment we are fully invested in equities. We have higher-risk mandates that can shift from 0% to 100% equity allocation. For the lower-risk mandates we have a maximum equity quota of 50%,' Wenzel says.

Currently most of Wenzel's clients, especially institutional clients, prefer lower-risk portfolios. That's why a year ago the team created a systematic risk mandate with a maximum equity quota of 50%, with the other 50% invested in bonds and volatility instruments.

'Whenever a black swan event happens we have to make sure we can move in the opposite direction to equity markets, and volatility does exactly that.'

Over the past year there have been several black swan events, Wenzel says, one obvious example being the market drop at the beginning of 2016.

'Some managers found a reason for this drop in China, others followed and this resulted in a 15% market shift over two weeks. Those kind of events come out of the blue, and it is quite difficult to catch them with our models.'

Despite these big risk-on/risk-off shifts being hard to model, Wenzel was proved correct in his hypothesis that the market had overreacted and would soon correct. He had already seen a similar drop in August 2015, which was again too sharp and too big.

'Our risk appetite indicator showed oversold conditions. We stayed in the market based on this. In October the market went up again, and we benefited from it. The same happened in the beginning of 2016.'

The company also makes use of a risk appetite indicator for fixed income, but liquidity considerations complicate the picture in this asset class.

'We can use the risk appetite indicator, which will tell us if now is the time to buy high yield bonds or avoid them. But we have to take a closer look at liquidity, otherwise it can really hurt you,' he says.

As well as liquidity Wenzel pays attention to quality in the fixed income universe and steers clear of junk bonds. 'Based

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on the risk appetite indicator we can tilt towards riskier assets, which means we might opt for BBB-rated bonds instead of AAA, but we still won't be investing in high yield.'

#### **MIND THE VALUE GAP**

The current market environment is quite tough, Wenzel says, as there are a lot of very dynamic participants competing.

'You don't have those old insurance companies and pension funds anymore, which are active and drive the market. There are more CTAs, hedge funds and high-frequency traders, which creates a tough environment as most of them have a pro-cyclical approach.'

On top of this Wenzel says the strong Swiss franc has an impact on exporters and the whole of the Swiss equity market, which is always a big part of the firm's equity mandate.

'I think we are really in some sort of currency war that no one will admit. Suddenly, the dollar drops 5% against the euro and the Swiss franc, then Draghi comes in and the euro weakens again. This whole currency situation makes markets more volatile and can result in abrupt changes, which is not good for stable development.'

In order to protect his portfolios from these abrupt changes in market conditions Wenzel maintains a mix of defensive and cyclical bets.

'We bought a lot of industrials at cheap valuations but at the same time we still have a preference for quality names from the healthcare and consumer staples sectors.'

In the five years since 2011 everyone has been buying

into defensive names as there were no real alternatives to equities and no one wanted to take on too much risk. This created a big valuation gap, which made some cyclical names highly attractive.

The combination of value and quality in global portfolios is something of an anomaly, Wenzel says.

'We live in a strange and complex world with central banks being very involved on the one hand and huge valuation discrepancies on the other. We have had a quality focus since 2011, but value started sending out positive signals only four weeks ago.'

### MANAGING EXPECTATIONS

Wenzel's biggest challenge remains the black-box mentality of many clients and managing their expectations of his models.

'Clients always think building everything on a model should work much better than when it all depends on human beings. This leads to very high expectations for the models, and this is probably one of the biggest issues for our company.'

Nonetheless, Wenzel doesn't plan any significant changes to his systematic approach. However, the uniqueness of ENISO Partners does throw up certain challenges when it comes to long-term expansion.

'We can't just acquire a firm with a traditional, fundamental approach and no systematic models. It is challenging to find another company that shares our philosophy.'

ENISO Partners focuses mainly on Swiss clients who hold money in their home country. Wenzel says Swiss clients have a different approach from Germans, who tend to be direct, but once they have chosen you they trust your decisions for the next five years.

'The Swiss are nitty-gritty clients. They come back on a monthly basis saying "What happened? Maybe your models don't work anymore?" This can be challenging.'

Although Swiss clients can be very demanding, the upside is they tend to show greater loyalty.

'UK or American clients might hop from one asset manager to another in order to jump on the bandwagon, which is a momentum play and therefore won't work. But Swiss clients don't do that.'

In terms of typical risk appetite Wenzel says the Swiss are not conservative but rather opportunistic, striving to outperform when the markets goes up and lie low during downturns.

'A typical Swiss feature is to always want to look on the bright side, no matter the situation. That's quite difficult sometimes because as an asset manager can't always guarantee that.'

Despite all the challenges that come with new regulations and the unstable economic environment, Wenzel clearly enjoys his job.

'As an independent asset manager you can make your visions come true. You cannot do this at a bank, where you just follow what the CIOs tell you. This is especially true with our systematic approach.'

Another drawback of working at the big banks, Wenzel says, is that committee members spend time and energy protecting themselves. This is something that is changing, however, as the era of banking secrecy finally comes to an end.

'You can't hide from responsibility any more. You have to generate performance in an environment with no banking secrecy as we begin to face competitors from across the globe.' ■

## GREEN LIGHTS ARE FLASHING

The ENISO Partners team use two fundamental models for portfolio construction: asset allocation and stock selection. This combination was introduced to avoid big downturns.

The asset allocation model rests on two pillars: the fundamental model and the psychological market component. The fundamental model looks at the monetary environment, how consumer sentiment develops and general valuations. However, the usefulness of this model in isolation is limited.

'We saw after 2008 that fundamental models have problems and didn't work well on their own. As a result, in 2011 we added a market psychological component, we call it a risk appetite indicator, which identifies the mood and sentiment in the market,' Wenzel says.

The risk appetite indicator is not driven by monetary policy or cheap valuations but instead indicates that market participants demonstrate positive risk appetite or risk aversion.

'Having added this risk indicator we were able to assess market in a much faster and more dynamic way than before.'

Both fundamental and psychological components are flashing green right now, Wenzel says, which indicates it's time to have full equity exposure.

'One green light for the fundamental model is that there is a lot of liquidity. Another green light is a result of the general market psychological environment, where risk appetite is still present.'

